

## Internal Revenue Service

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## Department of the Treasury

Washington, DC 20224

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Date:

September 28, 2010

### Legend:

Taxpayer A =

Taxpayer B =

Taxpayer C =

Taxpayer D =

State =

Date 1 =

Date 2 =

TRS A =

TRS B =

TRS C =

TRS D =

Dear :

This is in reply to a letter dated April 15, 2010, requesting rulings on behalf of Taxpayer A, Taxpayer B, Taxpayer C, and Taxpayer D (each a “Taxpayer” and, together, “Taxpayers”). Taxpayers have requested rulings regarding the definition of “qualified health care property” under section § 856(e)(6)(D)(i) of the Internal Revenue Code, for purposes of the related-party rent exception of § 856(d)(8)(B).

**Facts:**

Taxpayer A, Taxpayer B, and Taxpayer C were incorporated under the laws of State on Date 2. Taxpayer D was incorporated under the laws of State on Date 1. Each taxpayer intends to make an election under § 856 to be taxed as a real estate investment trust (REIT) for the 2009 or 2010 taxable year. Each taxpayer uses an overall accrual method of accounting and the calendar year as its taxable year.

Taxpayers’ primary business is the acquisition, ownership, and leasing of mixed-use communities (the Properties) that Taxpayers intend will qualify as health care properties. Taxpayer A owns all of the stock of TRS A, a corporation that has made a joint election with Taxpayer A to be treated as a taxable REIT subsidiary (TRS). Taxpayer B owns all of the stock of TRS B, a corporation that has made a joint election with Taxpayer B to be treated as a TRS. Taxpayer C owns all of the stock of TRS C, a corporation that has made a joint election with Taxpayer C to be treated as a TRS. Taxpayer D owns all of the stock of TRS D, a corporation that has made a joint election with Taxpayer D to be treated as a TRS. Each Taxpayer owns Properties and leases them to its TRS, each of which has hired an eligible independent contractor to operate the Properties.

The Properties are senior living communities that contain both independent living (IL) and assisted living (AL) units. The IL and AL units in each Property are located on the same campus, generally in one building, and share common area facilities for front desk reception, meals, social activities, and fitness activities. The same events and activities are offered to all residents, regardless of the type of unit they occupy. Each Property is operated by a management company that markets the properties as one integrated community with different service options and units available. A significant number of units in each of Taxpayers’ Properties are currently occupied by AL residents.

The same housekeeping, food services, administrative, and activities staff provide services for both IL and AL residents. Although nurses and other medical personnel primarily assist the AL residents, they also assist with the medical assessment that is performed to determine whether a resident will be placed in an AL or IL unit. Nurses and other medical personnel also assist IL residents in the event of an emergency.

In addition to the services customarily provided to residents of a rental housing unit, IL residents are provided with supportive services including: two or three meals a day in a central dining location; housekeeping and linen services; transportation to doctors' offices, banks, and retail stores; social and recreational activities; assistance with diet and mobility; assistance in obtaining prescription medication; and assistance with arranging physical therapy services. IL residents are required to call in to the front desk every morning, and if a call is not received, a staff member checks on the resident. The units also contain emergency call buttons, and staff members are available 24 hours a day to respond to any emergencies. Caregivers are trained in first aid and CPR and are instructed to call 911 for medical emergencies.

Residents of the AL units receive the services described above as well as assistance with activities of daily living (ADLs) such as bathing, dressing, toileting, ambulating, and eating. Caregivers may also prepare and administer medications to the AL residents. Caregivers also routinely check on the AL residents throughout the day.

The AL units are licensed under the laws of the state in which the Property is located. Each state requires AL residents to have a service plan agreement. IL residents are also given a service plan agreement, often with the clarification that the resident will not be receiving any ADLs or medication management. The service plan agreement states the scope of services to be provided and defines the levels of care available. A service plan is developed upon admission to the community and is updated regularly, including when there is a significant change in the resident's condition.

Employees are trained to inform IL residents and families if they observe a change in a resident's condition that might require a move to an AL service plan agreement. Transitioning from an IL unit to an AL unit within a Property typically requires a move to an available AL unit, an update of the resident's service plan, and an increase in the resident's monthly fee. In cases where a Property is licensed to accommodate either an IL or AL unit in every room, no moving may be necessary.

### **Law and Analysis:**

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, rents from real property.

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, rents from real property.

Section 856(d)(1) provides that rents from real property include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent

attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 856(d)(2)(B) provides that rents from real property does not include amounts received directly or indirectly from a corporation if the REIT owns 10 percent or more of the total combined voting power or 10 percent or more of the total value of the shares of the corporation.

Section 856(d)(8)(B) provides that amounts paid to a REIT by a TRS shall not be excluded from rents from real property by reason of section 856(d)(2)(B) when a REIT leases a qualified lodging facility or qualified health care property to a TRS, and the facility or property is operated on behalf of the TRS by a person who is an eligible independent contractor.

Section 856(e)(6)(D)(i) defines qualified health care property as any real property which is a health care facility.

A “health care facility” is defined in section 856(e)(6)(D)(ii) as a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in section 7872(g)(4)), or other licensed facility which extends medical or nursing or ancillary services to patients, and which was operated by a provider of such services that is eligible for participation in the Medicare program under Title XVII of the Social Security Act [subchapter XVIII of chapter 7 of Title 42 (42 U.S.C.A. § 1395 et seq.)] with respect to the facility.

In the present case, each Property is located in one building or on the same campus, and all of the AL units are licensed by the state in which they are located. When a resident eventually requires ADLs, the resident may transition from an IL unit to an AL unit (depending upon availability), or in the case at some Properties, the IL unit may be converted to an AL unit. While not all of the residents of the Properties receive assisted living services, a significant number of units in each of the Properties are currently occupied as AL units.

**Conclusion:**

Based on the facts as represented, we rule that the Properties are health care facilities within the meaning of section 856(e)(6)(D)(ii). Accordingly, amounts paid to each Taxpayer by its TRS shall not be excluded from rents from real property by reason of section 856(d)(2)(B) so long as the property is operated on behalf of the TRS by an eligible independent contractor.

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Taxpayers otherwise qualify as REITs under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayers requesting it. Taxpayers should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

David B. Silber  
David B. Silber  
Chief, Branch 2  
Office of Associate Chief Counsel  
(Financial Institutions & Products)